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SUBJECT: UKRAINE: DPM KLYUYEV ON NUCLEAR SUPPLY, OIL AND GAS,
OPIC, AND ECONOMIC REFORM ISSUES

REF: Kyiv 1507

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11. (SBU) Summary: Meeting with Ambassador June 20, Deputy Prime Minister Andriy Klyuyev told Ambassador that Ukraine intends to pursue diversification of nuclear fuel supplies. He stated that Ukraine is not seeking to have Russia supply all Ukrainian reactors in the next contract for nuclear fuel supply. On the Chornobyl shelter, Klyuyev said the GOU would write donors soon to argue the negotiations with the French-led Novarka consortium are going nowhere. Klyuyev noted the Rada had just passed useful amendments to the Production Sharing Agreement (PSA) legislation, and he hoped this would help move forward negotiations with Vanco. Ambassador mentioned Cardinal Resources' problems with mandatory sales at lower domestic prices as the kind of regulation that deters investment in domestic gas production. Klyuyev responded that the requirement could not be changed, although he hoped to provide some relief in the fall. He remained a skeptic on Odesa-Brody-Plock, arguing the Poles were overlooking technical problems with the proposed expansion. Klyuyev said Ministry of Finance opposition has stalled moving forward on a proposal to resolve the OPIC/Alliant dispute. Klyuyev also provided additional details on how the Yanukovych government has worked with McKinsey consultants to develop a comprehensive economic reform program. End Summary.

DIVERSIFYING NUCLEAR FUEL SUPPLIES

12. (SBU) Ambassador noted recent reports of Ukrainian-Russian discussions on nuclear cooperation. He highlighted the importance of diversification and competition, noting the example of France's dealings with Westinghouse, which eventually had lowered fuel supply costs. Klyuyev responded that diversification was Ukraine's intention. He related that the GOU was now in negotiation with the Russians, but was proposing that the contract be limited to 3 years and not cover all Ukrainian reactors. This would leave room for diversification, although he cautioned that Ukraine's options for supply were limited. Ambassador noted that Westinghouse had agreed with Minister of Fuels and Energy to provide a draft contract by July 31; Klyuyev said the GOU would look at it. Noting the example of a new exchange for exporting electricity implemented in Ukraine recently, which had increased returns and eliminated intermediaries, Klyuyev argued the GOU understood competition was advantageous.

GOU THINKS SHELTER NEGOTIATIONS AT AN IMPASSE

13. (SBU) Ambassador noted recent progress in reaching agreement with Holtec on restarting the Interim Spent Fuel Storage project at Chornobyl. Klyuyev agreed, but added the bigger problem was with the negotiations for the Chornobyl shelter. The GOU did not believe the French-led Novarka consortium will stay within the price quoted, and also had doubts about their ability to finish the project on time and with adequate quality. Novarka, Klyuyev charged, was delaying the contract negotiations, and he believed even the European Bank for Reconstruction and Development (EBRD) was starting to see the negotiations were not making progress. The GOU was writing a letter to donors, asking them to be active in moving the process forward. Ambassador asked what alternative there was to Novarka. Klyuyev thought they should negotiate with CH2MHill. Ambassador expressed doubts this was workable, as CH2MHill had withdrawn from the tender. (Comment: The GOU's observer in the Novarka negotiations, Serhiy Korsunskiy of the Ministry of Foreign Affairs, earlier approached post's DOE representative about a GOU letter to donors to drop Novarka. DOE representative cautioned Korsunskiy that donors might not favor a renewed tender, given the long delays involved.)

NEW PSA LAW PASSED

14. (SBU) Ambassador pushed for progress in the Vanco PSA negotiations. Klyuyev responded that the Rada's passage on June 19 of PSA law amendments would help a great deal. Klyuyev noted as early as 2003, he had seen the need for changes in Ukraine's PSA laws to bring in international investment in oil and gas production. Ambassador pointed out the President might not sign the law, as he regarded Rada action after June 2 as not legitimate. Klyuyev answered he hoped the President would sign the PSA law because it was important for the country. Vanco was ready to proceed with

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negotiations with or without a law, Ambassador noted. Klyuyev said they would reach agreement either way, but it would be tougher without the new amendments.

TWO-TIER GAS PRICE HURTS PRODUCERS

15. (SBU) Ukraine's price structure whereby domestic producers must sell at prices lower than domestic industry pays, in order to provide households with lower prices, is a disincentive to production, Ambassador noted. He cited the problems Cardinal Resources faced as an example. For the time being, Klyuyev said, the GOU could not change this 2-tier pricing, in part because the opposition had made gas and utility prices a major issue. However, he said he hoped to modify this pricing before the next heating season started. The GOU would set one price for smaller household and social users, with a sliding scale for other users. He hoped this would increase profitability for domestic producers. His interest was to develop gas production and spur investment from domestic and international companies, he maintained.

ODESA-BRODY-PLOCK SKEPTICISM

16. (SBU) As in previous meetings, Klyuyev expressed skepticism about the prospects for Odesa-Brody-Plock, which had been highlighted in the recent GUAM-Poland summit in Baku. Noting his knowledge of the technical difficulties faced by the Baku-Ceyhan pipeline in moving oil over high mountains, Klyuyev charged Poland was ignoring difficulties in the Plock extension of Odesa-Brody. The route Poland had proposed for the extension "makes a nice line on the map", and, he added, made sure the route crosses a minimal amount of Polish territory. Although Klyuyev supposed the Poles had chosen this approach to avoid land allocation problems in Poland, he noted the route thus crossed rough, hilly territory in Ukraine, which would add to the cost and technical difficulties of the project. Ukraine was more interested in projects, like a possible expansion of gas pipeline capacity (see septel), which had prospects for private investment.

LEGAL DIFFICULTIES FOR OPIC

¶7. (SBU) When Ambassador asked about OPIC, Klyuyev admitted he had major problems with the Ministry of Finance. For legal reasons, the Ministry of Finance had rejected Klyuyev's proposed mechanism to retire the claim, arguing it would require an amendment to the budget, which must be approved by the Rada. Klyuyev instead wants to use a cabinet resolution to permit Luhansk Cartridge Company to process old munitions and use the proceeds to retire the OPIC claim. He believed this approach had a legal basis and hoped the process issue could be resolved soon. Things looked much worse a month ago, he confided.

YANUKOVYCH'S REFORM PLANS

¶8. (SBU) Ambassador noted Rinat Akhmetov had told him recently of the GOU's work with consultants from McKinsey on a study of Ukraine's problems and proposals for a reform program (reftel). Klyuyev explained he had been directly involved in the process with McKinsey. Yanukovych had instructed Cabinet members to work directly with McKinsey experts on the program. Klyuyev had been responsible for: state monopolies and privatization, energy sector reform, transport infrastructure, and the machinery industry. He added that work was continuing on concrete proposals and ideas on how to implement the reforms, with broad participation inside the government. (Comment: In a later conversation with a U.S. adviser to opposition leader Tymoshenko, the consultant said that Tymoshenko had engaged the Rand Corporation in an analogous effort to develop a broad series of reform proposals for her party.)
TAYLOR